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89-663

No. ________

In The

Supreme Court of the United States

October Term, 1989

MARY MAYER,

Petitioner,

-against-

CHESAPEAKE INSURANCE COMPANY LIMITED, DWG CORPORATION, NVF COMPANY, NATIONAL PROPANE CORPORATION, APL CORPORATION, CHESAPEAKE FINANCIAL CORPORATION, SOUTHEASTERN PUBLIC SERVICE COMPANY, VICTOR POSNER, PEABODY INTERNATIONAL CORPORATION, THE PULLMAN COMPANY, and PTC ACQUISITION, INC.,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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QUESTIONS PRESENTED FOR REVIEW

1. Under Section 16 of the Securities Exchange Act of 1934, is a corporate greenmailer the beneficial owner of a large block of listed stock held by corporations controlled by him?

2. Is the payment of $5,600,000, which is conditioned upon the sale of all the subject stock held by the greenmailer-controlled corporations, consideration for such sale under Section 16(b) of the Exchange Act?

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The decision of the District Court is reported at 698 F. Supp. 52 (S.D.N.Y. 1988). The decision of the Court of Appeals is not yet officially reported. It appears, together with the dissent, in the Fed. Sec. L. Rep. (CCH) [current volume] at paragraph 94,504 (June 26, 1989). The Order of the Court of Appeals denying the Petition for Rehearing and suggestion for in banc (August 8, 1989) is reproduced at A. 42-43.[1]

JURISDICTION

The decision of the Court of Appeals for the Second Circuit was dated and filed on June 26, 1989. The Court of Appeals' denial of the Petition for Rehearing was dated and filed August 8, 1989. Jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

Section 16 of the Securities Exchange Act of 1934, 15 U.S.C. § 78p, is set forth in the appendix (A. 44-45), as is Section 13(d), 15 U.S.C. § 78m(d) (A. 46-49).

STATEMENT OF THE CASE

Just prior to August 7, 1985, a group of companies controlled by the notorious corporate exploiter, Victor

[1] "A." refers to the appendix annexed hereto.

Posner,[2] owned a total of about 23% of the outstanding common stock of Peabody International Corporation ("Peabody"), a company registered under Section 12 of the Exchange Act. In response to a proposed merger of Peabody with The Pullman Company ("Pullman") Posner caused another corporation controlled by him, APL Corporation, to purchase additional shares of Peabody stock. Between August 7, 1985 and September 19, 1985, APL purchased 1,421,800 shares of Peabody stock at prices ranging from $10.00 to $11.00 per share.

During this period of time, Posner demanded, in return for acquiescing in the merger, that he be bought out at a substantial premium. Pullman offered him a premium, but it was not enough. In fact, it was no premium at all; for while Pullman offered Posner $4,000,000, it was for an option to purchase Posner's Peabody holdings. The unrefuted evidence was that standard evaluation procedures showed that the option alone was worth at least $4,000,000.

Posner was not to be denied, however. He continued buying Peabody stock in APL, threatening to buy even more. By September 20, 1985 he owned 36% of the Company.

Ultimately, Pullman capitulated. It agreed to pay the Posner companies a premium of $5,600,000, while arranging the sale of all their Peabody stock to friendly third

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[2] Chesapeake Insurance Company, Ltd., DWG Corporation and National Propane Corporation. Together with APL Corporation ("APL"), these corporations are referred to as the Posner Group.

parties. The $5,600,000 premium payment was characterized as payment for a "standstill" agreement. But the payment of the $5,600,000 was expressly conditioned upon the sale of the stock and went only to the sellers, not to those who agreed to be bound by the "standstill" provisions.

Petitioner, a shareholder of Peabody, brought suit under Section 16(b) of the Exchange Act, 15 U.S.C. § 78p(b), to recover for the corporation (now Pullman) the short-swing profits realized by the Posner Group on its purchases and sales of Peabody stock.

The District Court held after trial that Posner, although receiving $10,000,000 in compensation from the companies controlled by him, was not the direct or indirect beneficial owner of the Peabody stock held by those companies because he did not receive a direct pecuniary benefit from the transaction. The District Court also held that, of the $5,600,000 premium payment, $4,000,000 was attributable to "standstill" covenants even though no one in the Posner group held any more stock of Peabody.[3] Treating only APL as an owner which had incurred short swing profits, the District Court rendered judgment in favor of the plaintiff (rather than Pullman) in the amount of $4,858.50 plus interest, that being the profits on the last 290,100 shares purchased by APL. In arriving at this computation, the District Court offset losses against gains.

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[3] The District Court held also that $600,000 was attributable to legal expenses.

The Court of Appeals for the Second Circuit affirmed in a 2 to 1 decision, with Judge Sweet (sitting by designation) dissenting. The Court of Appeals agreed with the District Court that Posner was not the beneficial owner of Peabody stock for the reason that the Posner Group companies controlled by him were owned in part by public shareholders. The majority also affirmed the District Court's finding that $4,000,000 was paid for the "standstill" covenants on the theory that an earlier $4,000,000 offer had been made. The Court of Appeals did not discuss the fact that the earlier offer entailed the purchase of an option worth at least $4,000,000. Nor did it discuss the testimony that "standstill" agreements are made with substantial stockholders who continue to hold shares in a corporation rather than ones who have disposed of their entire interest.

Plaintiff sought rehearing to point out that her primary authority, discussed by the Court of Appeals, *Blau v. Mission Corp.*, 212 F.2d 77 (2d Cir.), *cert. denied*, 347 U.S. 1016 (1954), also involved a corporation which was 40% owned by the public. Plaintiff pointed out that the distinction adopted by the Second Circuit majority between public corporations and private corporations, for purposes of finding beneficial ownership where control concededly exists, had never before been endorsed by any Court of Appeals. The petition for rehearing also pointed out that the Securities and Exchange Commission had, as recently as December, 1988, taken the position that control, rather than private ownership, was the determining factor in ascertaining beneficial ownership and that the definitions of beneficial ownership and control under Section 13 of the Act were applicable as well to Section 16. The Petition for Rehearing also pointed out that the

"standstill" agreement was worthless, that payment was made in direct proportion to stock ownership, and that the previous offers were linked to the purchase of the option; so that the entire $5,600,000 should have been considered as consideration paid for the purchase of stock.

On August 8, 1989, without opinion, the Court of Appeals denied the Petition for Rehearing.

REASONS FOR GRANTING THE WRIT

I. The Decision Of The Court Of Appeals Adopts A Novel Distinction Which Undermines Congressional Intent In Conflict With Decisions Of This Court, And In Conflict With Its Own Prior Decision And All Other Pertinent Authority.

This Court has frequently noted the important prophylactic purpose served by Section 16(b) of the Exchange Act. In *Kern County Land Co v. Occidental Petroleum Corp.*, 411 U.S. 582, 592 (1973), the Court stated:

> "As we have noted, 'the only method Congress deemed effective to curb the evils of insider trading was a flat rule taking the profits out of a class of transactions in which the possibility of abuse was believed to be intolerably great.' Reliance Electric Co. v. Emerson Electric Co., 404 U.S. 418, 422, 92 S.Ct. 596, 599, 30 L.Ed.2d 575 (1972)."

The Court cited with approval Congressional Committee reports directed at persons "vested with substantial control over corporations." *Id.*, at n.23. In *Reliance*

Electric, quoted by this Court in *Kern County,* this Court stated:

> "[W]here alternative constructions of the terms of § 16(b) are possible, those terms are to be given the construction that best serves the congressional purpose of curbing short-swing speculation by corporate insiders." *Reliance Electric Co. v. Emerson Electric Co.,* 404 U.S. 418, 424 (1972) (footnote omitted).

Section 16(b) defines as a person who must surrender short-swing profits those people "defined in § 16(a) of the Act, 15 U.S.C. § 78p(a), as '[e]very person who is *directly or indirectly* the beneficial owner of more than 10 per centum of any class of any equity security. . . .'" *Foremost-Mckesson, Inc. v. Provident Securities Co.,* 423 U.S. 232, 234 n.1 (1976) (emphasis supplied).[4] The most important criteria of beneficial ownership are control and direct or indirect economic benefit:

> In general, the courts will attribute to an insider the beneficial ownership of securities held in the name of relatives, family trusts, *businesses,* or other persons if the insider *either* had *control* over the timing of the transactions . . . or *participated directly or indirectly in the economic benefits of such transactions.*

Report of the [ABA] Task Force on Regulation of Insider Trading - Part II: Reform of Section 16, 42 Bus. Law. 1087, 1104 (1987) (emphasis added).

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[4] The Court of Appeals, relying on a pre-*Foremost-Mckesson* case, held erroneously that Section 16(b) is narrower than Section 16(a) (A. 22).

The agency responsible for the interpretation and enforcement of the Act, the SEC, agrees:

> in determining beneficial ownership for purposes of ascertaining who is a ten percent holder, the analysis properly should turn on the person's *potential for control*. . . . The identification of ten percent holders by the issuer will be facilitated by the use of Schedule 13D reports.[5]

Exchange Act Release No. 26333, [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶84,343 at 89,602-03 (December 2, 1988) (footnotes omitted). *Accord:* Exchange Act Release No. 34-18114 entitled "Interpretive Release on Rules Applicable to Insider Reporting and Trading," 4 Fed. Sec. L. Rep. (CCH) ¶26,062 at 19,063-21-22 (September 23, 1981):

> among the hallmarks of beneficial ownership are the right to control voting and transfer; the right to receive or control the disposition of income; and the right to control disposition of proceeds upon liquidation. Not all of these characteristics need be present in order for beneficial ownership to exist.

In drawing a distinction between intermediary private and public corporations the Court of Appeals formulated a position at odds with the statute, rejected by the SEC, never embraced by any Circuit Court of Appeals and specifically rejected in the case which the Court of Appeals recognizes as controlling, *Blau v. Mission Corp.*, 212 F.2d 77 (2d Cir.), *cert. denied*, 347 U.S. 1016 (1954). There, at the time of the second transaction in Tide Water

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[5] The Posner Group's Schedule 13D reports disclose that "[t]he reporting persons named therein may be deemed to be controlled directly or indirectly by Victor Posner and SMC."

securities effected by Development, the latter "was no longer just an alter ego of Mission. Its shares were freely traded . . . " *Id.* at 81. Mission owned 60% of Development. The public owned 40%. Nevertheless, the Court held that, because Mission (through its control of Development) was a beneficial owner of the Tide Water stock, it would have to account for the profits on the transaction.

The decision below is also at odds with the Ninth Circuit, where control was recognized as a determinative factor in *Whittaker v. Whittaker Corp.*, 639 F.2d 516 (9th Cir.), *cert. denied*, 454 U.S. 1031 (1981). In that case, William Whittaker, while acting as a director of the defendant corporation, engaged in short-swing trading of its stock for his mother's account. The Court determined that William was the beneficial owner of the shares held in his mother's name and, as such, held William accountable for the profit derived in violation of Section 16(b). In so holding, the Court took into account the relationship between William and his mother, his control over the trades, and the extent of his ability to enjoy the benefits derived therefrom. "On these facts – control over the securities and unfettered ability to use the money for his own benefit – any reasonable interpretation of 'profit realized by him' must encompass the instant case." 639 F.2d at 524.

The District Court here expressly found that Posner controlled all of the Posner Group companies (698 F. Supp. at 53), a finding which is amply supported by the record. Posner appointed all the directors and officers, and, more importantly, directed the purchases and sales of Peabody stock.

Permitting the type of transaction that took place here provides an easy avenue for evasion of the profit surrender provisions of Section 16(b). The decision below is particularly lamentable because the persons most likely to profit by using such facile devices will be the corporate raiders and greenmailers, many of whom, like Posner, have several companies under their control. The opinion, thus, not only sanctions an evasion of Section 16(b), but provides a method by which greenmailing raiders can effect their art without fear of surrendering short-swing profits. Judge Sweet, dissenting below, aptly noted:

> Unless the concept of control is defined to include beneficial ownership in a context such as this, disgorgement of short-swing profits can be evaded as it was here simply by splitting up purchasing entities. (A. 40-41).

II. The Court of Appeals Decision Is In Conflict With The Decisions Of Other Circuits, As Well As Its Own, By Exalting Form Over Substance.

Pullman arranged for Posner to sell his entire block of stock at the market price. As part of the arrangement, Pullman, which had found the buyers, agreed to pay an additional $5,600,000. The agreement, which was denominated a "standstill agreement" was expressly made conditional upon the Posner Group's receipt of the proceeds of the stock sale.

The "standstill agreement" provided that for a period of five years following the date of the agreement, neither the parties, nor any of their respective affiliates or associates would, with certain exceptions specified in the agreement, acquire any voting securities, solicit any proxies,

propose any sale of assets, seek to control or influence management, or impede the merger. As is self-evident from the provisions themselves, and as was confirmed by the testimony of the sole expert witness in the trial, these are covenants which are normally entered into by companies or their management with substantial shareholders who continue to hold their positions. Since the transaction with Posner required the immediate sale of his position, it made no sense to enter into a standstill agreement with him any more than with any of the score of other potential raiders on Wall Street.

Nevertheless, the Court below affirmed the finding that $4 million of the $5,600,000 payment was in return for the standstill covenants on the theory that an earlier $4 million offer had been made to Posner. This finding overlooks the fact that, when the earlier $4 million offer had been made, it was envisioned that Posner would continue to own the stock; and moreover, in return for the $4 million, Peabody was to be given an option to purchase which was worth at least $4 million. In short, the denomination of the agreement as a standstill agreement was a smoke screen. Its design and effect was to enable the funneling of $5,600,000 additional to the Posner Group as consideration for their sale of Peabody stock.[6]

The Court of Appeals' acceptance of the agreement as representing payments for valid standstill covenants constitutes an exaltation of form over substance which the

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[6] Indeed, only those signatories to the agreement who sold Peabody stock shared in the $5,600,000, and that sharing was in proportion to the number of shares they sold.

courts have refused to countenance in cases arising under Section 16(b). For example, in *Bershad v. McDonough*, 428 F.2d 693 (7th Cir. 1970), *cert. denied*, 400 U.S. 992 (1971), an insider, rather than sell his stock, issued an option to purchase it to a third party. The option was exercised long after the six month period had expired, but the Court of Appeals held that the realities of the transaction required treating the issuance of the option as tantamount to the sale of stock. The Court stated (428 F.2d at 697):

> "The phrase 'any purchase and sale' in Section 16(b) is therefore not to be limited or defined solely in terms of commercial law of sales and notions of contractual rights and duties. . . .The insider should not be permitted to speculate with impunity merely by varying the paper form of his transactions. The commercial substance of the transaction rather than its form must be considered, and courts should guard against sham transactions by which an insider disguises the effective transfer of stock. Cf. *Blau v. Allen*, 163 F. Supp. 702, 705-706 (S.D.N.Y. 1958)."

The Court, citing *Newmark v. RKO General, Inc.*, 425 F.2d 348 (2d Cir.), *cert. denied*, 400 U.S. 854 (1970), noted that the provisions of Section 16(b) cannot be evaded "by formalistic devices." 428 F.2d at 697, n.5.

The obvious importance of not permitting the evasion of Section 16(b) by the use of formalistic devices in the present case is the persistent growth of the practice of greenmail. The Second Circuit itself appeared to sense this possibility briefly in *Herrmann v. Steinberg*, 812 F.2d 63 (2d Cir. 1987). There a buy-out agreement was structured to make it appear that the statutory insider received

consideration solely for the withdrawal of a tender offer. The Court of Appeals held that "this discrete treatment has an appearance of artificiality." *Id.* at 66. The Court remanded the case to the District Court for determination of the amount attributable to consideration for the sale of stock. The instant case is thus inconsistent with the Second Circuit's prior holdings, and, if permitted to stand, would provide an easy road map for greenmailers to avoid the profit surrender provisions enacted by Congress in Section 16 of the Exchange Act.

CONCLUSION

For the foregoing reasons, petitioner urges the Court to grant her petition for a writ of certiorari.

Respectfully submitted,

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APPENDIX

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

MARY MAYER, Plaintiff, -against- CHESAPEAKE INSURANCE COMPANY LIMITED, DWG CORPORATION, NVF COMPANY, NATIONAL PROPANE CORPORATION, APL CORPORATION CHESAPEAKE FINANCIAL CORPORATION, SOUTHEASTERN PUBLIC SERVICE COMPANY, VICTOR POSNER, PEABODY INTERNATIONAL CORPORATION, THE PULLMAN COMPANY, AND PTC ACQUISITION, INC., Defendants.	85 Civ. 7958 (JFK) *FINDINGS OF FACT and CONCLUSIONS of LAW*

APPEARANCES:

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Wendy K. Goidel, Esq.

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JOHN F. KEENAN, United States District Judge

JOHN F. KEENAN, United States District Judge:

FINDINGS of FACT and CONCLUSIONS of LAW

Factual Findings

In the main, the facts have been stipulated to. They are also set forth in the Court's Opinion and Order of January 30, 1987. Three witnesses testified at trial and the deposition of defendant Victor Posner was received. Where that testimony is relied on for a factual conclusion, the Court will so note. Otherwise, the stipulated facts are the source of the Court's factual statements.

Plaintiff Mary Mayer ("Mayer") brought this action pursuant to Section 16(b) of the Securities Exchange Act of 1934 (the "Act"), 15 U.S.C. § 78(p)(b) ("Section 16(b)") against the named corporations and Victor Posner ("Posner"). She seeks to recover on behalf of defendant Peabody International Corporation ("Peabody") $5.6 million in short-swing profits allegedly realized by some defendants from the purchase and sale of Peabody stock. Mayer is a shareholder of common stock of Peabody, a Delaware corporation. The remaining defendant corporations, except for the Pullman Company ("Pullman") and PTC Acquisition, Inc. ("PTC"), are owned or controlled by Posner who resides in Miami Beach, Florida. He was and is Chairman, President and Chief executive officer of the other seven defendant corporations. As of September 21, 1985, Posner and Security Management Corporation ("SMC"), a private corporation and trust created for the benefit of Posner and his family, owned between 35% and 38% of the common stock of defendant NVF Company ("NVF") and 16.8% of the common stock of defendant DWG Corporation ("DWG"). As of September 21, 1985,

NVF owned a majority of the stock of defendant APL Corporation ("APL"), which is incorporated in New York. NVF also owned and controlled Chesapeake Financial Corporation, Inc. ("Chesapeake Financial"), incorporated in Florida, and Chesapeake Insurance Company, Ltd. ("Chesapeake Insurance"), a Bermuda corporation. DWG had a wholly-owned subsidiary, defendant National Propane Company ("Propane"), incorporated in Delaware. DWG also controlled and was the majority shareholder of Southeastern Public Service Company, a Delaware corporation.

Just prior to August 7, 1985, Chesapeake Insurance, DWG and Propane amongst them held a total of approximately 23% of Peabody's common stock. The companies, together with their affiliates and Victor Posner, filed schedules 13D disclosing their investment and stating that they may be deemed to constitute "a group" for purposes of Section 13 of the Securities Exchange Act of 1934, 15 U.S.C. § 78(m), and Rule 13d-5, 17 C.F.R. § 240.13d-5 promulgated thereunder.

Between November 1983 and April 1984, Peabody and Chesapeake Insurance negotiated concerning a proposed consensual tender offer for Peabody stock and, towards the end of that period, a possible merger. The negotiations ended in April 1984 without success. Shortly thereafter, Peabody made a self-tender offer for 2.3 million of its shares, but withdrew the offer after Chesapeake Insurance, DWG and Propane brought a derivative suit in Dade County, Florida, to enjoin the offer.

On June 19, 1985 Peabody signed a defensive merger agreement with Pullman, under which Peabody's stockholders were to receive 1.65 shares of Pullman stock for each share of Peabody stock they owned. The two corporations were to merge under the name "The Pullman-Peabody Company." Peabody also granted Pullman an option to purchase over 2 million shares of Peabody stock should any person acquire or offer to acquire a 20% interest in Peabody, or should any shareholder or group of shareholders holding 20% of Peabody's stock increase their holdings by 5% or more. This option essentially "locked up" 18% of Peabody's stock, diluted the holdings of the shareholders affiliated with Posner ("the Posner Group") and gave Pullman the ability to block a competing proposal.

Between August 7, 1985 and September 19, 1985, APL purchased over 1,421,800 shares of Peabody Stock. It had previously owned no Peabody stock. During the summer of 1985, representatives of Peabody and Pullman, among them Thomas M. Begel ("Begel"), Chief Executive Officer of Pullman and Steven Shulman ("Shulman"), a Pullman director, met with Posner to attempt to convince him not to oppose their merger. Failing to do so, Peabody and Pullman signed two additional agreements on August 27, 1985: a Preferred Stock Exchange Agreement and an Amendment Agreement. Under the Preferred Stock Exchange Agreement, Peabody issued Pullman 1.5 million shares of "Series A Preferred Stock," each share being entitled to seven votes which were required under the Amendment Agreement to be cast in favor of the Peabody-Pullman merger.

On August 21, 1985 Peabody brought suit in the District of Connecticut against Posner, Chesapeake Insurance, DWG, Propane and APL alleging that they had violated Sections 10(b) and 13(d) of the Act by filing false schedules 13D and had manipulated the market by failing to disclose an intention to take over Peabody. The defendants in that action filed counterclaims against Peabody and its directors and impleaded Pullman and its Chairman.

On September 5, 1985, the 13D reporting defendants – Chesapeake Insurance, Chesapeake Financial, DWG, Propane, Southeastern Public Service Company (SEPSCO), and APL – filed an amendment to the Schedule 13D in which they announced their opposition to the Pullman-Peabody merger and disclosed that "[t]he reporting persons presently expect to challenge in an appropriate legal proceeding, among other things, the purported granting of [the poison pill] option and the purported issuance of such preferred stock."

On September 20, 1965, Peabody, Pullman and the Posner Group entered into a settlement agreement under which the pending litigations in Florida and Connecticut were discontinued in exchange for a payment from Peabody and Pullman to the Posner Group of $5.6 million. Peabody and Pullman agreed to pay the Stockholders a total of $5.6 million. Five million dollars of that sum was distributed among the four Stockholder Defendants as follows: $1,770,000 to APL, $2,870,000 to Chesapeake Insurance $330,000 to Propane, and $30,000 to DWG. The remaining $600,000 was paid to defendants' counsel. The Posner Group also agreed to refrain for five years from

taking particular actions which would lead to their control of Peabody or Pullman and from interfering with the Pullman-Peabody merger. On the same day the settlement agrement was executed, the Posner Group sold its holdings of Peabody stock to unidentified institutional investors at a price of $10.375 per share.

Mayer alleges that the $5.6 million paid to the Posner Group under the settlement agreement formed part of the consideration for the sale of the Posner Group's holdings in Peabody stock. She further contends that each member of the Posner Group was a beneficial owner of more than 10% of the outstanding common stock of Peabody immediately prior to August 7, 1985. Accordingly, Mayer alleges, the purchase of Peabody stock by APL between August 7, 1985 and September 19, 1985, and the sale of the Posner Group's shares of Peabody stock on September 20, 1985 fall within the ambit of Section 16(b) and $5.6 million paid to the Posner Group must be disgorged and paid to Peabody.

Plaintiff called one Charles Davis as her expert witness. He testified that the settlement agreement and the standstill portions thereof were worth zero dollars and that the $5.6 million payment under the agreement was therefore a hidden premium for the sale of the stock. The Court rejects this opinion. Mr. Davis had no particular life experience, education or background which supplies reliability, credence or prestige to his opinion. His undergraduate degree was in physics and his doctorate in mathematical logic. Although an obviously intelligent man, his business background supplied him with no yardstick to evaluate a standstill agreement. Moreover, he had never previously testified in a case invloving Section

16(b) of the Act nor did he have any particular reason to be able to evaluate a standstill agreement where litigation was involved.

Thomas Begel, the Director, President and Chief Executive Officer of Pullman, was called by plaintiff and testified to the negotiations with Posner during the summer of 1985 whereby he sought to convince Posner that the merger of Peabody and Pullman was a good idea. Begel wanted Posner's support for the merger. They met together in Florida on June 24, 1985, July 18, 1985, July 29, 1985 and August 13, 1985. Begel and Posner spoke by telephone on August 15, 1985.

On July 18, 1985 Begel offered $2 million for a standstill agreement whereby Chesapeake Insurance, DWG and Propane would refrain from increasing their 23% interest in Peabody and would vote for the merger. It was not contemplated, so cross-examination of Begel developed, that the three corporations would sell their combined 23% of the Peabody stock as a condition of receiving the $2 million. Posner, on behalf of the three corporations rejected Begel's July 18 offer. At the July 29 meeting, Begel offer $4 million for the same standstill agreement, again without any promise that the three corporations would sell their stock in Peabody.

Between August 7, 1985 and September 19, 1985, APL acquired 1,421,800 shares of Peabody common stock in open market purchases.

Jerome Coopersmith, Senior Vice President and Chief Financial Officer of several of the defendant corporations, who reports to Posner testified for the defense. He testified that none of the corporate defendants received any

financial benefit from the sale of Peabody stock that they did not own. Manufacturers Hanover Bank statements (Defendants' Exh. H) corroborate that the sale proceeds were deposited in the bank accounts of DWG, Chesapeake Insurance, Propane and APL and Stipulated Fact 39 states that "[e]ach of the four selling defendants received the entire proceeds from the sale of the shares owned by it." Coopersmith also testified that Posner himself got nothing personally directly from the sales. There is no evidence that defendants commingled funds and no credible evidence that Posner's salary was augmented as a result of the trading in Peabody stock.

On August 23, 1985 APL became record owner of more than 10% of Peabody's common stock bringing it within the ambit of Section 16(b). It purchased 290,100 shares after that and by September 19, 1985 APL owned 11.4% of Peabody's common stock. *See* Stipulated Fact 28.

CONCLUSIONS OF LAW

Section 16(b) of the Act provides in pertinent part that:

> For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer . . . within any period of less than six months . . . shall inure to and be recoverable by the issuer . . . .

Plaintiff contends that all members of the so-called Posner group, as well as Posner, were beneficial owners of

the Peabody stock within the meaning of Section 16(b). Although the definition of "beneficial ownership" has not been widely discussed, courts which have considered the issue have required that the beneficial owner or "insider" realize some direct pecuniary benefit from the purchase and sale of the securities. *See Blau v. Lehman*, 368 U.S. 403, 414 (1962); *Margolies v. Rea Brothers*, 1982-83 Fed. Sec. L. Rep. Transfer Binder (CCH) ¶ 99, 261 (S.D.N.Y. 1983); *CBI Industries, Inc. v. Horton*, 682 F.2d 643, 646 (7th Cir. 1982). In the present case, Mr. Coopersmith testified that none of the corporate defendants received any financial benefit from the sale of shares they did not own. The proceeds from the sale of the shares was divided among DWG, Chesapeake Insurance, Propane and APL according to the number of shares previously held by each. The evidence also indicated that Posner himself received no direct benefit from the sale of the shares. Only APL received proceeds from the sale of 290,100 Peabody shares bought on or after August 23, 1985, which shares fell within the purview of Section 16(b). Thus, only APL can be deemed a beneficial owner of shares under Section 16(b).

Plaintiff also argues, that the $5.6 million paid to the Posner group was actually payment for the sale of the Posner group shares and should thus be considered profit under Section 16(b). The Court disagrees and concludes that the standstill agreement was not worthless. The standstill agreement ended substantial opposition to the merger of Peabody and Pullman, insured peace for Pullman-Peabody for five years and terminated two different lawsuits which had challenged the merger. It is also significant that the Posner group had been offered $4 million as late as July 29, 1985 without any requirement that its

Peabody shares be sold. Courts have held that so-called "standstill agreements," which guarantee that one party will not seek to attempt a takeover of another, do have value in and of themselves. *See Herrmann v. Steinberg*, 812 F.2d 63, 67 (2d Cir. 1987); *Colan v. Continental Telecom, Inc.* 616 F. Supp. 1521, 1527-28 (S.D.N.Y. 1985), *aff'd*, 788 F.2d 2 (2d Cir. 1986). Thus, the entire $5.6 million is not subject to Section 16(b) treatment. In the Court's view, the standstill agreement was worth at least $4.6 million to Pullman-Peabody ($4 million for the settlement and standstill agreement and $600,000 for counsel fees and litigation expenses). Hence, $1 million of the $5.6 million should be regarded as consideration for the sale of the Peabody shares by APL.

The next question is what profits APL must disgorge, as the only entity subject to Section 16(b) liability. The only shares which come under Section 16(b) are the 290,100 Peabody shares purchased by APL afer August 23, 1985, since APL did not become the beneficial owner of more than 10% of Peabody stock until August 23. *See* Joint Pre-Trial Order, Stipulated Fact 28. *See Foremost-McKesson v. Provident Securities Co.*, 423 U.S. 232, 251 (1976); *Herrmann*, 812 F.2d at 64. The total purchase price of these shares was $3,061,012.50 and adding brokerage commissions of $9189.00, the relevant purchase price is $3,070,201.50. *See* Joint Pre-Trial Order, Stipulated Fact 27. *See Herrmann*, 812 F.2d at 65 (only non-incidental expenses not deductible from short swing profits); *Texas International Airlines v. National Airlines, Inc.*, 714 F.2d 533, 542 (5th Cir. 1983) (brokerage commissions properly deductible from short swing profits), *cert denied*, 465 U.S.

1062 (1984); *Reece Corp v. Walco Nat. Corp.*, 565 F. Supp. 158, 166 (S.D.N.Y. 1983) (same).

The price received for the sale of APL's 1,421,800 shares was $14,751,175 (1,421,800 x $10.375/per share net to APL). *See* Joint Pre-Trial Order. Stipulated Fact 39. Since $1 million or 17.8% of the $5.6 million paid to the Posner Group was found by this Court to constitute consideration for the sale of the shares, $315,060 (17.8% of $1,770,000 received by APL) should be added to the money received by APL for the sale of all its 1,421,000 shares. This amount added to the actual purchase price amounts to a total of $15,066,235. This amount divided by the 1,421,800 shares comes to $10.60 per share. Thus, APL received a total of $3,075,060 only for the 290,100 subject shares. Thus, APL's short-swing profits amount to $4858.50 (sale price of $3,075,060.00 minus purchase price of $3,070,201.50).

CONCLUSION

For the foregoing reasons, plaintiff is awarded $4858.50 plus interest as short-swing profits obtained by defendant in violation of Section 16(b) of the Securities Act. Judgment should be entered accordingly and this case is to be removed from the active docket of this Court.

SO ORDERED.

Dated: New York, New York
October 11, 1988

/s/ JOHN F. KEENAN
JOHN F. KEENAN
U.S.D.J.

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 791-August Term, 1988
(Argued: February 8, 1989 Decided: June 26, 1989)
Docket No. 88-7905

MARY MAYER,

Plaintiff-Appellant,

-v.-

CHESAPEAKE INSURANCE COMPANY LIMITED, DWG CORPORATION, NVF COMPANY, NATIONAL PROPANE CORPORATION, APL CORPORATION, CHESAPEAKE FINANCIAL CORPORATION, SOUTH-EASTERN PUBLIC SERVICE COMPANY, VICTOR POSNER, PEABODY INTERNATIONAL CORPORATION, THE PULLMAN COMPANY, and PTC ACQUISITION, INC.,

Defendants-Appellees.

Before:

KEARSE and WINTER, *Circuit Judges*,
and SWEET, *District Judge*.*

*Honorable Robert W. Sweet, Judge of the United States District Court for the Southern District of New York, sitting by designation.

Appeal from a judgment of the United States District Court for the Southern District of New York, John F. Keenan, *Judge*, awarding plaintiff $4,858.50, plus interest, as short-swing profits obtained by defendant APL Corporation, in violation of 15 U.S.C. § 78p(b), and dismissing the complaint against the other defendants. *See* 698 F. Supp. 52 (1988).

Affirmed.

Judge Sweet dissents, in a separate opinion.

RICHARD M. MEYER, New York, New York (Wendy K. Goidel, Milberg Weiss Bershad Specthrie & Lerach, New York, New York, on the brief), *for Plaintiff-Appellant*.

COLLEEN MCMAHON, New York, New York (Orin S. Snyder, Paul, Weiss, Rifkind, Wharton & Garrison, New York, New York, on the brief), *for Defendants-Appellees*.

KEARSE, *Circuit Judge:*

Plaintiff Mary Mayer appeals from a final judgment entered in the United States District Court for the Southern District of New York following a bench trial before John F. Keenan, *Judge*, awarding $4,858.50, plus interest, against defendant APL Corporation ("APL"), on her claim that APL and the other defendants controlled by defendant Victor Posner (collectively the "Posner companies") had obtained short-swing profits in the common stock of Peabody International Corporation ("Peabody"),

in violation of § 16(b) of the Securities Exchange Act of 1934 ("Exchange Act" or "1934 Act"), 15 U.S.C. § 78p(b) (1982), and dismissing the complaint against Posner and his other companies. On appeal, Mayer contends that the district court erred in finding that Posner and the Posner companies other than APL were not beneficial owners of APL's Peabody stock for purposes of § 16(b), and in failing to include in the sales price of that stock the entire amount of a settlement paid to Posner companies by Peabody and The Pullman Company ("Pullman"). For the reasons below, we affirm the judgment.

I. BACKGROUND

The historical facts are not in dispute. The pertinent events, as found by the trial court of stipulated by the parties, were as follows.

A. *The Parties and the Events*

The defendant Posner companies are Chesapeake Insurance Company Limited ("Chesapeake Insurance"), DWG Corporation ("DWG"), NVF Company ("NVF"), National Propane Corporation ("Propane"), Chesapeake Financial Corporation ("Chesapeake Financial"), Southeastern Public Service Company ("Southeastern"), and APL. Posner and his family entities owned or controlled 16.8% of the common stock of DWG, which in turn owned 100% of Propane and 63.6% of Southeastern; Southeastern owned 48% of the common stock of Chesapeake Financial; Chesapeake Financial owned 100% of Chesapeake Insurance. Posner and his family entities also owned or controlled between 35% and 38% of the common stock of NVF, which in turn owned 56.7% of APL.

NVF and Propane owned a total of some 24% of Chesapeake Financial; The remaining 28% of Chesapeake Financial was owned by subsidiaries of NVF. DWG, Southeastern, NVF, and APL were publicly traded companies, each listed on one or more stock exchanges. Posner was the chairman, president, and chief executive officer of all seven of these corporations.

Prior to November 1983, DWG, Chesapeake Insurance, and Propane became holders of common stock of Peabody, a corporation registered on the New York Stock Exchange. Chesapeake Insurance purchased a total of 2,305,800 shares between May 4, 1981, and November 7, 1983; DWG purchased 20,900 shares on June 24, 1983; and Propane purchased a total of 266,300 shares between July 12, 1983, and September 19, 1983. Between November 1983 and April 1984, Peabody and Chesapeake Insurance engaged in negotiations looking toward a merger.

After the negotiations ended unsuccessfully, Peabody made a tender offer for 2.3 million shares of its own stock; this offer was withdrawn after Chesapeake Insurance, DWG, and Propane brought a derivative suit in a Florida state court seeking to enjoin the offer. On June 19, 1985, Peabody signed a defensive merger agreement with Pullman and granted Pullman an option to purchase more than 2 million shares of Peabody stock if, *inter alia,* any group of stockholders holding 20% or more of Peabody's stock increased its holdings by 5% or more. The option effectively gave Pullman the power to block any competing merger proposal.

Just prior to August 7, 1985, Chesapeake Insurance, DWG, and Propane owned a total of about 23% of Peabody common stock, consisting entirely of the shares they had purchased prior to November 8, 1983. APL owned no shares of Peabody prior to August 7, 1985. Between August 7 and September 19, 1985, APL purchased some 1,421,800 shares of Peabody stock at prices ranging from $10 to $11 per share. As of August 23, 1985, APL was the record owner of more than 10% of Peabody's common stock; it purchased an additional 290,100 shares between that date and September 19, 1985.

Each of the Posner companies that owned Peabody stock filed statements with Securities and Exchange Commission ("SEC" or "Commission") pursuant to § 13(d) of the Exchange Act, 15 U.S.C. § 78m(d) (1982 & Supp. V 1987), and SEC Rule 13d-5, 17 C.F.R. § 240.13d-5 (1988) ("13D Schedules"). The 13D Schedules stated that "[t]he reporting persons named [therein] may be deemed to be controlled directly or indirectly by Victor Posner." DWG acknowledged its control of the Peabody shares owned by its wholly owned subsidiary Propane; in all other respects, each Posner company disclaimed beneficial ownership of the Peabody shares owned by any other Posner company.

During the summer of 1985, Peabody and Pullman met with Posner several times, seeking to persuade him not to oppose their proposed merger. In one July meeting, Pullman offered to pay $2 million of a standstill agreement whereby Chesapeake Insurance, DWG, and Propane would refrain from increasing their 23% interest in Peabody and would not oppose the merger. At the next meeting, Pullman increased this offer to $4 million. There

was no contemplation that Chesapeake Insurance, DWG, and Propane would sell their Peabody stock as part of this agreement; rather, they were urged to vote that stock in favor of the merger. Posner rejected these offers and refused to support the merger.

On August 21, 1985, Peabody commenced a suit in federal court in Connecticut against Chesapeake Insurance, DWG, Propane, APL (collectively the "Posner Group"), and Posner, alleging that they had violated §§ 10(b) and 13(d) of the 1934 Act by filing false 13D Schedules and had manipulated the market by failing to disclose an intention to take over Peabody. Those defendants filed counterclaims and indicated their intention to challenge the option granted to Pullman, as well as Peabody's subsequent issuance to Pullman in August 1985 of 1.5 million shares of preferred stock.

On September 20, 1985, all of these disputes were resolved. Peabody, Posner, and the Posner companies other than NVF entered into a settlement agreement under which, *inter alia,* the pending suits in Connecticut and Florida were discontinued, in exchange for a payment of $5.6 million from Peabody and Pullman to the Posner Group. Of this sum, $600,000 was paid to the defendant's counsel, and $5 million was distributed as follows: $1,770,000 to APL, $2,870,000 to Chesapeake Insurance, $330,000 to Propane, and $30,000 to DWG. The settlement agreement included standstill provisions in which Posner and his companies agreed to refrain for five years from, *inter alia,* (1) purchasing Peabody or Pullman stock, (2) taking actions that would lead to their control

of Peabody or Pullman, and (3) interfering with the Peabody-Pullman merger. On the day the settlement agreement was executed, Chesapeake Insurance, DWG, Propane, and APL sold their holdings of Peabody stock, through investment bankers, to unidentified institutional investors at a net price of $10.375 per share.

B. *The Present Suit*

Mayer commenced the present action as a stockholder of Peabody, seeking to recover on its behalf short-swing profits under § 16(b) of the 1934 Act. She contended that because of the relationship between APL and the other members of the Posner Group, APL should be considered to have been a 10% owner of Peabody stock prior to August 7, 1985, and that APL's purchases in August and September 1985 and sales in September 1985 thus resulted in short-swing profits on all 1,421,800 of its shares. She also contended that all of the $5.6 million settlement amount was paid to the Posner Group as a result of the APL stock purchases and thus should be considered part of the sale price of APL's Peabody stock.

In an opinion published at 698 F. Supp. 52 (1988), the trial judge largely rejected Mayer's contentions. He found that each member of the Posner Group received proceeds from the sale of shares in proportion to its ownership of shares; that Posner himself did not receive any direct benefit from the sale of the shares; and that none of Posner's corporations received any financial benefit from the sale of shares it did not own. The district judge concluded that each Posner company's interest and profit should thus be considered individually. He ruled that only the 290,100 shares bought by APL after it became a

10% owner of Peabody common stock were within the purview of § 16(b) and that hence only profits from the sale of those shares should be disgorged.

The court also found that only $1 million of the $5.6 million paid to the Posner Group by Peabody and Pullman represented payment for the sale of stock. The court found that the settlement agreement, which (a) eliminated substantial opposition to the proposed merger, (b) terminated two lawsuits, and (c) ensured that Posner companies would not seek to take over Peabody or Pullman for five years, was not worthless. In light of the summer offer by Pullman of $4 million for a standstill agreement that would not have required any Posner companies to sell their Peabody stock, the court found that the value of the settlement agreement was $4 million. Deducting that $4 million plus the $600,000 for attorneys' fees from the $5.6 million payment, the court found that $1 million should be regarded as consideration for the sale of the Peabody shares.

After (a) calculating APL's share of the $1 million and the percentage of that share that was attributable to the stock purchased after APL became a 10% owner, (b) adding the resulting sum to the amount APL received from the institutional investors who purchased the shares, and (c) subtracting what APL had paid for the shares, the court found that APL's profit on the 290,100 shares subject to § 16(b) was $4,858.50. Judgment was entered against APL in the amount of $5,980.80, which included prejudgment interest.

The claims against Posner and the other Posner companies were dismissed. This appeal followed.

II. DISCUSSION

On appeal, Mayer contends principally that the district court erred (1) in not regarding Posner and each of his companies as joint beneficial owners, within the meaning of § 16(b), of the Peabody stock owned by each member of the Posner Group, and (2) in not regarding the entire $5.6 million payment to the Posner Group as payment for APL's Peabody stock. We reject both contentions.

A. *§ 16(b) Liability*

Section 16(b) of the Exchange Act provides, in pertinent part, as follows:

> For the purpose of preventing the unfair use of information which may have been obtained by [the] beneficial owner [of more than 10 per centum of any class of the equity securities of a company registered on a national stock exchange], director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer . . . within any period of less than six months . . . shall inure to and be recoverable by the issuer. . . .

15 U.S.C. § 78p(b); *see* Exchange Act § 16(a), 15 U.S.C. § 78p(a) (1982). Thus, with respect to companies such as Peabody, § 16(b) provides that a 10% owner, director, or officer (collectively "insiders") can be required to disgorge to the company any profit made by him on any purchase and sale of the company's securities within a six-month period. *See, e.g., Feder v. Martin Marietta Corp.,*

406 F.2d 260, 262, 268-69 (2d Cir. 1969), *cert. denied*, 396 U.S. 1036 (1970). Since this provision for forfeiture of short-swing profits applies only to insiders, the appropriate inquiries with respect to § 16(b) liability in the present case were (1) whether APL, which profited from short-swing transactions, was an insider, and (2) as to any other person who was an insider, whether the profit on the APL transactions was realized "by him." The district court answered the first question partly in the negative, and answered the second question entirely in the negative. For the reasons below, we find no errors in these answers.

A company may be the beneficial owner of stock in a variety of ways, including through its absolute control over a subsidiary that owns the stock. *See Blau v. Mission Corp.*, 212 F.2d 77, 80 (2d Cir.) *("Mission"), cert. denied*, 347 U.S. 1016 (1954). In *Mission*, the parent corporation ("Mission") purchased more than 10% of the stock in Tide Water Associated Oil Company ("Tide Water") and formed a wholly owned subsidiary ("Development") to which it transferred the Tide Water stock. Within six months, Mission began purchasing additional shares of Tide Water in the market; it continued these purchases for some two years and eventually transferred more Tide Water shares to Development. In the meantime, Mission distributed part of its Development stock to Mission stockholders as dividends but retained "60 per cent of Development and hence obviously did not relinquish actual control of the Tide Water block of stock." *Id.* The ultimate question was whether transfer of Tide Water shares to Development constituted a sale within the meaning of § 16(b). As to the preliminary question of whether Mission was beneficial owner of the Tide Water

stock and hence was an insider to which § 16(b) applied, we concluded as follows:

> There can be no doubt that Mission, by virtue of its absolute control of Development, was indirectly the owner of all Tide Water stock held by Development and was therefore an insider throughout the period in issue.

Mission, 212 F.2d at 80; *see id*. 80-81 (second transfer, but not first, held to be a § 16(b) sale). *Cf. Blau v. Lamb*, 363 F.2d 507, 526 (2d Cir. 1966) (individual who owned 97% of one corporation and 100% of another is deemed owner of the stock held by either, and hence sale of stock by one corporation to the other was not a § 16(b) transaction since individual remained the owner), *cert. denied*, 385 U.S. 1002 (1967).

Consistent with these rulings, the SEC has adopted the position that, for purposes of the reporting requirement under § 16(a) of the 1934 Act, which is somewhat broader than the § 16(b) requirement that short-swing profits be disgorged, *see Whiting v. Dow Chemical Co.*, 523 F.2d 680, 685 n.8, 687 (2d Cir. 1975); SEC Exchange Act Release No. 7824, 4 Fed. Sec. L. Rep. (CCH) ¶26,030 (Feb. 14, 1966), a person in control of a closely held company is deemed to be the beneficial owner of all securities held by that company, reasoning that in such circumstances "all of the indicia of beneficial ownership are present." SEC Exchange Act Release No. 18114, 4 Fed. Sec. L. Rep.(CCH) ¶26,062, at 19,063-8 (Sept. 23, 1981) ("Rel. No. 18114"). In contrast, the Commission has suggested that a shareholder of a publicly held corporation is not deemed a beneficial owner of securities held by that corporation. "Normally, an insider who is a shareholder of a publicly

held company would not be obligated to report his interest in that company's transactions in the registered security, since he would not usually be considered to be, even indirectly, the beneficial owner of that security." *Id; see also* SEC Exchange Act Release No. 26333, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶84,343, at 89,604 n. 70 (Dec. 2, 1988) ("Rel. No. 26333") ("holdings generally have not been attributed to the individual shareholders of a corporate shareholder except in situations involving closely held corporations").

In *Mission,* the beneficial ownership question was explored in order to determine whether the defendant was an insider within the meaning of § 16(b), *i.e.,* whether he was the beneficial owner of more than 10% of the registered company's stock. In a number of other cases, the courts have explored the concept of beneficial ownership as it pertained to a person who was a director or officer of the registered company, *i.e.,* an insider to whom § 16(b) applied regardless of the size of his stock holding. *See CBI Industries, Inc. v. Horton,* 682 F.2d 643, 646 (7th Cir. 1982); *Whittaker v. Whittaker Corp.,* 639 F.2d 516, 523-27 (9th Cir.), *cert. denied,* 454 U.S. 1031 (1981); *Whiting v. Dow Chemical Co.,* 523 F.2d at 685-89. In these cases, the key question was whether the profit was made, as required for a disgorgement under § 16(b), "by" the insider. The answer turned on whether or not the insider obtained a direct pecuniary benefit from the profit.

Where the insider has absolute control over the transactions and directly benefits from the profits, he is liable under § 16(b). In *Whittaker,* the president and chairman of the registered company had a power of attorney from his

ailing mother who was a substantial holder of the company's stock. He "'exercised virtually complete control over his mother's affairs,'" 639 F.2d at 523 (quoting district court's findings), having sole discretion over transactions for her account, including the ability to borrow large sums of money from her to finance his own investments without having to consider paying the money back, posting security, or paying interest. The *Whittaker* court, noting that this insider exercised absolute control over the securities and had the unfettered ability to use the profits made from transactions in them, and that it was "'obvious that Mr. Whittaker stood to gain on any profits he might make for his mother through the purchase and sale of Whittaker Corporation securities,'" *Id.* (quoting district court's findings), concluded that profits inuring to the account of the mother were made "by" him.

Even where the insider's control is not absolute, he may be held liable under § 16(b) if he directly benefits from the transactions. In *Whiting v. Dow Chemical Co.*, we held that a director of a registered company, who purchased stock in the company within six months after the sale of stock by his wife, could be required to disgorge profit thereby realized. Stating that "[t]he question is whether the term 'beneficial owner[ship]' includes securities from which the spouse has shared 'benefits substantially equivalent to ownership,' " 523 F.2d at 686 (quoting SEC Exchange Act Release No. 7793, 4 Fed. Sec. L. Rep. (CCH) § 26,031, at 19,057-4 (Jan. 19, 1966)), we were influenced by the facts the all expenditures made by the couple appeared to insure to the benefit of both, *Whiting v. Dow Chemical Co.*, 523 F.2d at 688 ("there is hardly

anything Mrs. Whiting gets out of the ownership that appellant does not share"); that the § 16(b) "transactions were part of a common plan, jointly managed by husband and wife," *id.*; and that the money with which the husband purchased his stock was part of the proceeds of his wife's sale of the stock. We concluded that the fact that the husband did not have *"exclusive"* control over the stock, *id.* at 685 (emphasis in original), was not dispositive in light of the other indicia that the profit was enjoyed "by" the husband.

Even where an insider has complete control over a block of the stock of the registered company, if in fact he is not a beneficial owner in the traditional sense of that term and receives no direct pecuniary benefit from a profit in it, the profit is not received "by him" and hence need not be disgorged pursuant to § 16(b). In *CBI Industries, Inc. v. Horton*, Horton, a director of the company, was a trustee of a trust established by his mother for his two (by then adult) sons; stock in the company was originally the trust's only asset. Though there was a bank cotrustee, the court assumed for purposes of analysis that Horton had sole and unfettered discretion and control over the trust res. Holding that "profit realized by a corporate insider means direct pecuniary benefit to the insider, as in the factual settings of *Whiting* and *Whittaker*," 682 F.2d at 646, the *CBI Industries* court concluded that if Horton was not "able to use income or assets of the trust to pay his personal expenses," *id.* at 647, the resulting profit was not received "by him" within the meaning of § 16(b). *Cf. Blau v. Lehman*, 368 U.S. 403 (1962) (partner of firm that held shares in registered company or which partner was a director (and hence an insider) was liable

under § 16(b) for only his own partnership share of the profits of sale; Court refused to treat entire profit of firm as received "by him"); *see also* Note, *"Beneficial Ownership" Under Section 16(b) of the Securities Exchange Act of 1934,* 77 Colum. L. Rev. 446, 461 (1977) (insider should not be held liable for the transactions of other unless he "has received a direct pecuniary benefit").

Similarly, in considering § 16(b) claims against an individual shareholder of a corporation that engaged in short-swing transactions in shares of a registered company of which the individual was a director and hence an insider, the district courts have generally held that the insider's benefit as a director or as a shareholder of the transacting corporation was too indirect to make him responsible for disgorgement of profits under § 16(b). *See, e.g., Rothenberg v. Jacobs,* [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) § 94,199 (S.D.N.Y. Jan.11, 1989); *Margolies v. Rea Bros. Plc.,* [1982-1983 Transfer Binder] Fed. Sec. L. Rep. (CCH) § 99,261, at 96,178-79 (S.D.N.Y. June 30, 1983) (Sweet, *J.*). In *Margolies,* the complaint alleged that one Salomon, who was chairman of a registered corporation ("Canal"), was also chairman of and owned some 10% of another corporation ("Rea"); Rea and its wholly owned subsidiary owned more than 10% of the stock of Canal and had engaged in short-swing transactions in that stock. The complaint did not allege that Salomon himself had engaged in any short-swing transactions in Canal stock but rather sought to attribute Rea's transactions to him. The district court dismissed the complaint as to Salomon. Relying on the principles enunciated in *Blau v. Lehman and CBI Industries,* the court reasoned that though Salomon was an insider of Canal by

virtue of his position as its chairman, he could not be held liable under § 16(b) unless Rea's short-swing profits resulted in a direct pecuniary benefit to him. The court held that Salomon's position as a shareholder and director of Rea gave him only an indirect benefit:

> As [a director and shareholder of Rea, directly involved in its control], . . . [Salomon] does not stand to realize direct pecuniary benefit from trades executed by Rea and its subsidiary Guernsey. He may benefit indirectly as a shareholder or director but, following the rule of *CBI*, such indirect benefit is insufficient to establish liability under section 16(b).

Margolies v. Rea Bros. Plc., [1982-1983 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶99,261, at 96,179. Insofar as the corporation engaging in the short-swing transactions is not a closely held corporation, we agree with the analysis and conclusion set forth in *Margolies*.

These principles were properly applied by the district court in the present case. The only defendant that made both purchases and sales of Peabody stock within a six-month period was APL. APL itself was not an insider with respect to Peabody until August 23, because prior to that date it owned less than 10% of Peabody's common stock and did not own or control any other company that owned Peabody stock. Thus, the court properly found that APL, the person that engaged in the short-swing transactions, was not an insider for the period prior to August 23 and was an insider thereafter.

Prior to August 7, at least two of the other Posner companies, *i.e.*, Chesapeake Financial and its wholly owned subsidiary Chesapeake Insurance, were clearly

insiders with respect to Peabody, since Chesapeake Insurance, wholly owned by Chesapeake Financial, owned more than 10% of Peabody's common stock. Arguably DWG, Propane, Southeastern, and NVF too may have been Peabody insiders by virtue of the fact, *inter alia*, that Chesapeake Financial, a Peabody insider, was a corporation owned entirely by these four companies or their subsidiaries. Thus, the question with respect to the Posner companies other than APL was whether the profit on APL's sales of its stock was received "by" those companies. The court properly answered this question in the negative. NVF was the only company that owned any shares of APL; but APL was a publicly traded company, not a closely held corporation, and hence NVF's interest was too indirect to warrant a conclusion that APL's profit was received by NVF. The interests of the other defendants was even further removed, for none of them owned any APL stock and hence they could not be deemed to have either control over APL or beneficial ownership, in any traditional sense, of APL's Peabody stock. Finally, the court found that in fact all of the Posner companies received proceeds from the sale of their Peabody stock only in proportion to the number of shares they owned; none of the Posner companies received any financial benefit from the sale of shares that it did not own.

As to Posner individually, the record suggests that he was not a Peabody insider for § 16(b) purposes. He owned no Peabody stock directly. Though he owned stock in NVF and DWG, these were by no means closely held corporations; each was publicly traded on two stock exchanges. Even if Posner were to be deemed a Peabody insider by virtue of his holdings in those companies,

however, he was properly held not liable for APL's short-swing profits since the district court found that he individually received no direct benefit from the sale of the APL shares.

In sum, there is no indication in the record that any defendant other than APL was able to use for his or its own purposes or expenses APL's Peabody stock or the proceeds from the sale of that stock. The district court's findings are not clearly erroneous, *see* Fed. R. Civ. P. 52(a), and we conclude that the court properly ruled that the defendants other than APL were not liable for APL's short-swing profits.

Finally, we reject Mayer's suggestion that we should reach a different conclusion because of Posner's position as chairman, president, and chief executive officer of all of the Posner companies. Her contention that his positions and the interrelationships among these defendants require that they all be deemed joint beneficial owners of the Peabody stock owned by any one of them would have us, in effect, engraft onto § 16(b) the contours of § 13(d) of the Exchange Act, which is concerned with a person's potential for control of the voting or disposition of the registered company's shares. Focusing on control, § 13(d) requires reports by 5% owners of stock as to, *inter alia*, "the number of shares of such security which are beneficially owned, and the number of shares concerning which there is a right to acquire, directly or indirectly, by (i) such person, and (ii) by each associate of such person . . . ." 15 U.S.C. § 78m(d)(l)(D). We have noted that the purpose of § 13(d) is "to alert the marketplace to . . . rapid aggregation or accumulation of securities" and to permit investors to "assess the potential for changes in corporate

control." *GAF Corp. v. Milstein,* 453 F.2d 709, 717 (2d Cir. 1971), *cert. denied,* 406 U.S. 910 (1972). Since the focus of § 13(d) is control, we have not viewed the group of persons who are subject to the strict liability imposed by § 16(b) for disgorgement of profits as congruent with the group of persons to whom the control-oriented § 13(d) applies. *Compare* 453 F.2d at 715-17 (beneficial ownership determined by reference to voting control) *with Whiting v. Dow Chemical Co.,* 523 F.2d at 686 (beneficial ownership determined by reference to all the benefits of ownership). Nor has the SEC in the past viewed the different thrusts of the two sections as warranting defining the two groups identically. Under § 13(d), the SEC has promulgated Rule 13d-3, which "sets out a very detailed definition of beneficial ownership for purposes of the reporting requirements under Section 13(d) and the Commission's tender offer rules." Rel. No. 18114, at 19,063-7 n.17. The Commission has noted, in connection with § 16(a), whose scope, as indicated above, is broader than that of § 16(b), that "[w]hile the concepts of beneficial ownership under Section 16(a) and under Rule 13d-3 have much in common, the former stresses the economic benefit to be derived from the securities and the latter emphasizes the ability to control or influence the voting or disposition of the securities. As a result, different determinations of beneficial ownership under the section and rule are possible." Rel. No. 18114, at 19,063-7 n.17.

Though the Commission has recently proposed a new rule, *see* Proposed SEC Rule 16a-1(a), 4 Fed. Sec. L. Rep. (CCH) ¶ 26,013, at 19,029 (Dec. 2, 1988), which would extend § 16(b) liability to insiders having merely an indirect pecuniary interest, thereby changing existing law, *see*

Rel. No. 26333, at 89,603 & n.57, and perhaps unifying the concepts of beneficial ownership under §§ 16(a), 16(b), and 13(d), *see* Rel. No. 26333, at 89,602-03, the proposed rule does not govern the present case. Under the principles developed with respect to existing law, the relationships between and among Posner and the Posner companies, four of which were publicly traded companies, with the remainder being subsidiaries of those public companies, were not sufficient to support a finding that any defendant other than APL received a direct pecuniary benefit from the sale of APL's Peabody stock and hence were insufficient to warrant the imposition of § 16(b) liability on any defendant other than APL.

B. *Amount of Disgorgeable Profits*

Mayer also contends that the district court erred in its calculation of the amount of APL profit to be disgorged. She argues, *inter alia,* that the court erred (1) in finding that the settlement agreement had any value independent of the Posner Group's sale of its stock holdings, (2) in not including as profits the $600,000 designated as payments for attorneys' fees, and (3) in failing to match APL's lowest purchase prices for Peabody stock with the highest sales price. We find no merit in these contentions.

In *Herrmann v. Steinberg,* 812 F.2d 63, 66 (2d Cir. 1987), we considered the proper allocation of payments made by the target of a hostile tender offer to the suitor in order to end the takeover threat. Some $297 million was designated by the parties as the purchase price for the suitor's 4.2 million shares, 100 shares of which were

subject to § 16(b), and $28 million was labeled as expenses incurred in connection with preparation for the tender offer. We ruled that reimbursement for expenses such as legal fees incurred other than in buying or selling the stock that was subject to § 16(b) should not be attributed to the sale of that stock, and that "[a]ny part of the $28 million that the district court finds was paid solely in consideration for [the suitor's] agreement to call off its proposed tender offer should of course be excluded from [the] calculation of short swing profits." *Id.* at 67 n.6. On the other hand, we stated that any amount the target would not have paid if the suitor had not also agreed to sell its shares should be attributed to the sales price of the shares. Accordingly, we instructed the district court to determine what portion, if any, of the $28 million was paid for expenses not incurred in connection with § 16(b) transactions and what portion, if any, was paid solely for cancellation of the tender offer; these sums were to be deducted from the $28 million, and the remainder would reflect the portion of $28 million attributable to the sales price of the § 16(b) shares.

The district court in the present case appropriately followed this process. It found that the $5.6 million payment pursuant to the settlement agreement had three components: $600,000 for attorneys' fees, $4 million for the standstill provisions and termination of the litigation, and the remaining $1 million for sale of all the stock. These findings must be upheld on appeal unless they are clearly erroneous. *See* Fed. R. Civ. P. 52(a); *Anderson v. City of Bessemer City*, 470 U.S. 564, 573-74 (1985); *Banco Nacional de Cuba v. Chemical Bank*, 822 F.2d 230, 240 (2d Cir. 1987). Where there are two permissible views of the

evidence, the court's selection between them cannot be termed clearly erroneous. *Anderson v. City of Bessemer City*, 470 U.S. at 574. We find no error here.

Though there was a rider to the settlement agreement stating that the parties' obligations were conditioned on the Posner Group's receipt of the proceeds of the sale of their stock to the institutional investors, the court was not required to infer that the entire amount of the settlement payment was therefore additional payment for the stock. Nor was the court required to accept the opinion of Mayer's expert witness that the standstill provisions had no value. *See Champion Spark Plug Co. v. Gyromat Corp.*, 603 F.2d 361, 367-68 (2d Cir. 1979) (within the province of trier of fact to determine what weight to accord opinion of expert witness), *cert. denied*, 445 U.S. 916 (1980); *see also Philip v. Mayer, Rothkopf Industries*, 635 F.2d 1056, 1061 (2d Cir. 1980) (appellate court has "limited latitude" to question district court's reliance on expert testimony). The court's decision to ascribe a value of some $4 million to the standstill provisions was based on, *inter alia*, (1) the fact that in exchange for the payment, Posner and his companies agreed that for a period of five years they would refrain from (a) taking any action designed to frustrate the proposed Pullman-Peabody merger, (b) seeking to take control of Peabody or Pullman, and (c) purchasing securities in Peabody or Pullman, and (2) the evidence that some weeks before the settlement, Pullman had offered to pay the Posner companies $4 million for their forbearance without any requirement that they sell their stock. The court's inferences that the bargained-for forbearances and the termination of the pending lawsuits

had some value and that that value was $4 million were permissible and thus may not be overturned.

Nor do we find error in the court's conclusion that the $600,000 labeled as attorneys' fees were not part of the price for the stock. The parties had been engaged in litigation in two fora with respect to control of Peabody. The court was entitled to infer that this payment represented reimbursement for expenses not connected with the purchase or sale of the APL stock.

In sum, we find no basis for overturning the district court's finding that only $1 million of the $5.6 million settlement payment represented payment for the Posner Group's sale of its stock.

Finally, we reject Mayer's contention that the district court erred in not matching APL's lowest purchase price for shares against the highest sales price. To effectuate the remedial purposes of § 16(b), courts should compute the amount of profit from short-swing sales in a manner that will maximize the plaintiff's recovery. *See Blau v. Lehman*, 286 F.2d 786, 791 (2d Cir. 1960), *aff'd*, 368 U.S. 403 (1962). Where there are multiple purchases and multiple sales, and hence some uncertainty as to the profit or loss with respect to the short-swing shares, the § 16(b) profits are to be calculated by matching the "lowest price in [with the] highest price out." *Smolowe v. Delendo Corp.*, 136 F.2d 231, 239 (2d Cir.), *cert. denied*, 320 U.S. 751 (1943). As the Seventh Circuit has noted, however, "[n]othing . . . suggests that [Smolowe's] 'lowest price in, highest price out' rule was meant to have application in cases where only one purchase or one sale has taken place so that trade-matching is not a problem . . . ." *Allis-Chalmers*

Manufacturing Co. v. Gulf & Western Industries, 527 F.2d 335, 355 (7th Cir. 1975) (quoting *Smolowe v. Delendo Corp.,* 136 F.2d at 239), *cert. denied,* 423 U.S. 1078 (1976).

Though APL made multiple purchases of Peabody stock, it sold all of that stock to institutional investors in one block sale for the price of $10.375 per share. It was therefore unnecessary for the district court to resort to the *Smolowe* procedure for matching trades. The court correctly subtracted the aggregate price that APL paid for the 290,100 shares it purchased after August 23, 1985, from the total amount it received for those shares.

CONCLUSION

We have considered all of Mayer's arguments and found them to be without merit. The judgment of the district court is affirmed.

SWEET, *District Judge,* dissenting:

Because in my view the majority opinion permits evasion of the insider trading provisions of § 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b) (1982), I respectfully dissent.

According to the majority opinion, despite Posner's ownership of or control over all of the appellee Posner companies, and his role as Chairman, President and CEO of each of the companies, neither Posner nor any of the individual companies, except APL, the only purchaser within the group of shares during the short swing period, was a beneficial owner of the Peabody stock. According

to the majority, APL became a beneficial owner subject to disgorgement of short swing profits only when its holdings of Peabody reached ten percent of the common stock, despite the ownership of twenty-three percent of APL's shares by other Posner companies. This interpretation of beneficial ownership in the context of a control contest defeats the aim of Congress to prohibit short swing profits by insiders.

The express purpose of § 16(b)'s prohibition on short swing profits is to prevent a person with inside information – arbitrarily denominated as a beneficial owner of 10% or more of a class of security – from unfairly using that information to make short-swing profits. Thus, if a shareholder has more than 10% of a class of securities, he or she is presumed to have access to inside information.[1]

The crucial issue for § 16(b) enforcement is to determine whether a person is a beneficial owner. The majority recognizes that control is a factor of beneficial ownership, but concentrates on the question of whether or not an insider has obtained a direct pecuniary benefit from the profit. Among other cases, the majority relies upon *Margolies v. Rea Bros. Plc,* [1982-1983 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,261 (S.D.N.Y. June 30, 1983) to show that one cannot be liable under § 16(b) without realizing a direct pecuniary benefit. However, *Margolies*

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[1] As the SEC has recognized, "Section 16 is a strict liability provision under which an insider's short-swing profits can be recovered regardless of whether that insider actually was in possession of material, nonpublic information." SEC Exchange Act Release No. 26333, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,343, at 89,599 (Dec. 2, 1988).

involved purchases and sales of stock between related companies and the viability of a claim against the chief executive of the related companies who had himself engaged in no sales. Here, the context is a struggle for corporate control conducted by related companies, all of which had made prior purchases and sold on the same day under the same agreement. Moreover, as this member of the Circuit Court, I feel less constrained to praise the reasoning of the district court in *Margolies*, particularly given the factual distinctions between the two cases, despite my tentative respect for the author of *Margolies*.

In order to determine who is a beneficial owner under § 16(b), the definition which would best serve Congress's goals of curbing benefits from trading on inside information is one which includes those who are able to exert control over a company and thereby possess an indirect pecuniary interest in the shares at issue.

In recognition of Congress's goal, this court held in *Whiting v. Dow Chemical Co.* that "[f]or purposes of the family unit, shares to which legal title is held by one spouse may be said to be 'beneficially owned' by the other, the insider, if the ordinary rewards of ownership are used for their joint benefit." 523 F.2d 680, 688 (2d Cir. 1975). In the interests of curbing short swing profits by corporate insiders, the rule set forth in *Whiting* should control any case in which there is a coordinated purchase of shares of stock in a control contest for the "joint benefit" of a group. *Whiting* should have been extended to the context of members of a corporate family, and APL would thus be considered an insider of Peabody prior to its purchase of shares. Under the reality of a control

contest in which a group is acting in a coordinated manner, all should be considered beneficial owners for short swing profit purposes.

A recent SEC release lends support to this interpretation. For the first time, the SEC has attempted to define the term "beneficial owner" for reporting and profit recovery purposes. The SEC's proposed definition of "beneficial owner" includes "any person who, directly *or indirectly*, through any contract, arrangement, understanding, relationship or otherwise has or shares a pecuniary interest in the subject securities." Proposed SEC Rule 16a-1(a)(2), 4 Fed. Sec. L. Rep. (CCH) ¶ 26,013, at 19,029 (Dec. 2, 1988) (emphasis added). In its background to the proposed changes, the SEC explains:

> Congress, in applying Section 16 to ten percent holders, intended to reach those persons who could be presumed to have access to inside information because of their interest in the issuer's securities. Thus, in determining beneficial ownership for purposes of ascertaining who is a ten percent holder, the analysis properly should turn on the person's potential for control. The proposed rules would rely on Section 13(d) definitions for determining who is a ten percent holder.

SEC Exchange Act Release No. 26333, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,343, at 89,602 (Dec. 2, 1988).

This proposed definition of "beneficial owner" seeks to reflect Congress's intention to limit insider trading, and, as the majority noted, the definition would in all likelihood unify the concept of beneficial ownership under § 16(a), 16(b) and 13(d). Presumably the SEC in

assessing that intent is well aware of the effect of its definition in today's marketplace. As the Supreme Court has said, "where alternative constructions of the terms of § 16(b) are possible, those terms are to be given the construction that best serves the congressional purpose of curbing short-swing speculation by corporate insiders." *Reliance Electric Co. v. Emerson Electric Co.* 404 U.S. 418, 424 (1972) (footnote omitted).

Posner, as President, Chairman and CEO of each of the Posner companies, had control over the group's financial investments and made decisions regarding the companies' acquisition and disposition of Peabody common stock in connection with his takeover attempt. Thus, the group as a whole and each member of the group, united by its interest in Peabody, possessed an interest in the disposition of the APL shares and was a beneficial owner of Peabody before August 7, 1985 as a result of the combined ownership of twenty-three percent of Peabody. Such a conclusion acknowledges the reality of Posner's position confirmed by the standstill agreement.

APL got its profits – the proceeds from the sale of its shares plus its proportional amount of the $5.6 million, a total of $1.77 million – by virtue of the nature of this group relationship and the standstill agreement covering all the Posner companies. The sales were an integral part of the settlement and standstill agreements in September, 1985. Therefore, profits on all 1,421,800 shares of Peabody which APL purchased within six months prior to the September 20 sale should be subject to disgorgement under § 16(b).

As is indeed appropriate, the majority has upheld Judge Keenan's factual finding that the standstill agreement had value derived from the termination of litigation and the standstill provisions that Posner and his companies would refrain for five years from attempting to frustrate the Pullman-Peabody merger, seeking control of Peabody or Pullman, or buying securities in either firm. However, the only litigation which the Posner companies gave up were threats of counterclaims which would challenge both the option granted to Peabody and Peabody's issuance to Pullman of preferred stock in the action filed by Peabody against Posner, and a derivative action brought by Chesapeake Insurance, DWG and Propane against Peabody's self-tender, which had already caused Peabody to withdraw its self-tender proposal, leaving only a claim for attorneys fees by the derivative plaintiffs, which presumably were worth considerably less than the $4 million attributed to the standstill agreement by Judge Keenan. Without ownership of stock in Peabody, Posner and the corporate members of his group posed no more threat to the Peabody-Pullman merger than any other raider on Wall Street. As a matter of logic, were I free to do so, I would quarrel with the conclusion that the five year bar is worth the $4 million attributed to it by the District Court's finding of fact.

Leaving the value of the standstill agreement aside, I respectfully dissent, concluding as I do that APL was a beneficial owner of Peabody common stock before it crossed the 10% threshold on August 23, 1985, and that short swing profits on all 1,421,800 shares purchased by APL between August 7 and September 19, 1985 should be disgorged. Unless the concept of control is defined to

include beneficial ownership in a context such as this, disgorgement of short swing profits can be evaded as it was here simply by splitting up purchasing entities.

Conclusion

For the reasons set forth above, I dissent.

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

At a stated term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse, in the City of New York, on the 8th day of August one thousand nine hundred and eighty-nine.

MARY MAYER,

Plaintiff-Appellant,

- v. -

CHESAPEAKE INSURANCE COMPANY LIMITED, DWG CORPORATION, NVF COMPANY, NATIONAL PROPANE CORPORATION, APL CORPORATION, CHESAPEAKE FINANCIAL CORPORATION, SOUTHEASTERN PUBLIC SERVICE COMPANY, VICTOR POSNER, PEABODY INTERNATIONAL CORPORATION, THE PULLMAN COMPANY AND PTC ACQUISITION, INC.,

Defendants-Appellees.

Docket No. 88-7905

(Filed Aug. 8, 1989)

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by counsel for Plaintiff-Appellant MARY MAYER

Upon consideration by the panel that heard the appeal, it is

Ordered that said petition for rehearing is DENIED.

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges of the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

Elaine B. Goldsmith
Clerk

by /s/ Kathleen Bowman

15 U.S.C. §§ 78p(a) and (b) [Sections 16(a) and 16(b) of the Exchange Act]:

Sec. 16(a): Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to section 12 of this title, or who is a director or an officer of the issuer of such security, shall file, at the time of the registration of such security on a national securities exchange or by the effective date of a registration statement filed pursuant to section 12(g) of this title, or within ten days after he becomes such beneficial owner, director, or officer, a statement with the Commission (and, if such security is registered on a national securities exchange, also with the exchange) of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close of each calender month thereafter, if there has been a change in such ownership during such month, shall file with the Commission (and if such security is registered on a national securities exchange, shall also file with the exchange) a statement indicating his ownership at the close of the calender month and such changes in his ownership as have occurred during such calendar month.

Sec. 16(b): For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by

the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

15 U.S.C. § 78m(d) [Section 13(d) of the Exchange Act]:

(d)(1) Any person who, after acquiring directly or indirectly the beneficial ownership of any equity security of a class which is registered pursuant to section 12 of this title, or any equity security of an insurance company which would have been required to be so registered except for the exemption contained in section 12(g)(2)(G) of this title, or any equity security issued by a closed-end investment company registered under the Investment Company Act of 1940, is directly or indirectly the beneficial owner of more than 5 per centum of such class shall, within ten days after such acquisition, send to the issuer of the security at its principal executive office, by registered or certified mail, send to each exchange where the security is traded, and file with the Commission, a statement containing such of the following information, and such additional information, as the Commission may by rules and regulations prescribe as necessary or appropriate in the public interest or for the protection of investors –

(A) the background, and identity, residence, and citizenship of, and the nature of such beneficial ownership by, such person and all other persons by whom or on whose behalf the purchases have been or are to be effected;

(B) the source and amount of the funds or other consideration used or to be used in making the purchases, and if any part of the purchase price is represented or is to be represented by funds or other consideration borrowed or otherwise obtained for the purpose of acquiring, holding, or trading such security, a description of the transaction and the names of the parties thereto, except that where a source of funds is a loan made in the ordinary course of business by a bank, as defined in section 3(a)(6) of this title,

if the person filing such statement so requests, the name of the bank shall not be made available to the public;

(C) if the purpose of the purchases or prospective purchases is to acquire control of the business of the issuer of the securities, any plans or proposals which such persons may have to liquidate such issuer, to sell its assets to or merge it with any other persons, or to make any other major change in its business or corporate structure;

(D) the number of shares of such security which are beneficially owned, and the number of shares concerning which there is a right to acquire, directly or indirectly, by (i) such person, and (ii) by each associate of such person, giving the background, identity, residence, and citizenship of each such associate; and

(E) information as to any contracts, arrangements, or understandings with any person with respect to any securities of the issuer, including but not limited to transfer of any of the securities, joint ventures, loan or option arrangements, puts or calls, guaranties of loans, guaranties against loss or guaranties of profits, division of losses or profits, or the giving or withholding of proxies naming the persons with whom such contracts, arrangements, or understandings have been entered into, and giving the details thereof.

(2) If any material change occurs in the facts set forth in the statements to the issuer and the exchange, and in the statement filed with the Commission, an amendment shall be transmitted to the issuer and the exchange and shall be filed with the Commission, in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(3) When two or more persons act as a partnership, limited partnership, syndicate, or other group for the purpose of acquiring, holding, or disposing of securities of an issuer, such syndicate or group shall be deemed a "person" for the purposes of this subsection.

(4) In determining, for the purposes of this subsection, any percentage of a class of any security, such class shall be deemed to consist of the amount of the outstanding securities of such class, exclusive of any securities of such class held by or for the account of the issuer or a subsidiary of the issuer.

(5) The Commission, by rule or regulation or by order, may permit any person to file in lieu of the statement required by paragraph (1) of this subsection or the rules and regulations thereunder, a notice stating the name of such person, the number of shares of any equity securities subject to paragraph (1) which are owned by him, the date of their acquisition and such other information as the Commission may specify, if it appears to the Commission that such securities were acquired by such person in the ordinary course of his business and were not acquired for the purpose of and do not have the effect of changing or influencing the control of the issuer nor in connection with or as a participant in any transaction having such purpose or effect.

(6) The provisions of this subsection shall not apply to –

(A) any acquisition or offer to acquire securities made or proposed to be made by means of a registration statement under the Securities Act of 1933;

(B) any acquisition of the beneficial ownership of a security which, together with all other

acquisitions by the same person of securities of the same class during the preceding twelve months, does not exceed 2 per centum of that class;

(C) any acquisition of an equity security by the issuer of such security;

(D) any acquisition or proposed acquisition of a security which the Commission, by rules or regulations or by order, shall exempt from the provisions of this subsection as not entered into for the purpose of, and not having the effect of, changing or influencing the control of the issuer or otherwise as not comprehended within the purposes of this subsection.

(2)

No. 89-663

In The
SUPREME COURT OF THE UNITED STATES
Ocober Term, 1989

MARY MAYER,

Petitioner,

-against-

CHESAPEAKE INSURANCE COMPANY LIMITED, DWG CORPORATION, NVF COMPANY, NATIONAL PROPANE CORPORATION, APL CORPORATION, CHESAPEAKE FINANCIAL CORPORATION, SOUTHEASTERN PUBLIC SERVICE COMPANY, VICTOR POSNER, PEABODY INTERNATIONAL CORPORATION, THE PULLMAN COMPANY, and PTC ACQUISITION, INC.

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

BRIEF IN OPPOSITION

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19 pp

Questions Presented

1. Should the Court, in the absence of any conflict between circuits, abandon the so-called "direct pecuniary benefit" rule that has long been used to determine beneficial ownership under § 16(b) of the Securities and Exchange Act of 1934?

2. Should the Court review the affirmed factual finding that no respondent received any direct pecuniary benefit from transactions in stock owned by any other respondent?

3. Should the Court review the affirmed factual finding that $4.6 million of a $5.6 million payment was paid in consideration for the settlement of litigation and a five-year standstill agreement?

Supreme Court Rule 28.1 List

Pursuant to Supreme Court Rule 28.1, respondents APL Corporation and NVF Company state that their corporate parents may be deemed to be Security Management Corp. and Victor Posner, and respondents Southeastern Public Service Company, Chesapeake Insurance Company Limited, Chesapeake Financial Corporation and National Propane Corporation state that their corporate parent may be deemed to be respondent DWG Corporation, and that in turn their corporate parents may be deemed to be Security Management Corp. and Victor Posner. Security Management Corp. and Victor Posner may also be deemed to control Salem Corporation and Pennsylvania Engineering Corporation; its 91% owned subsidiary, Birdboro Corporation and Fischbach Corporation may be deemed to be controlled by APL Corporation. In addition, Wilson Brothers may be deemed to be controlled by DWG Corporation.

This brief is submitted only on behalf of respondents Chesapeake Insurance Company Limited, DWG Corporation, NVF Company, National Propane Corporation, APL Corporation, Chesapeake Financial Corporation, Southeastern Public Service Company, and Victor Posner.

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SUPREME COURT OF THE UNITED STATES

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MARY MAYER,

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CHESAPEAKE INSURANCE COMPANY LIMITED, DWG CORPORATION, NVF COMPANY, NATIONAL PROPANE CORPORATION, APL CORPORATION, CHESAPEAKE FINANCIAL CORPORATION, SOUTHEASTERN PUBLIC SERVICE COMPANY, VICTOR POSNER, PEABODY INTERNATIONAL CORPORATION, THE PULLMAN COMPANY, and PTC ACQUISITION, INC.,

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF IN OPPOSITION

Preliminary Statement

Applying a settled rule of law to an almost entirely stipulated record, the United States District Court for the Southern District of New

York (Keenan, J.) ruled in this case that stock in Peabody International Corporation ("Peabody") owned by four separate corporations could not be aggregated in order to turn one of those corporations into a statutory "insider" under § 16(b) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78p(b). 1/ The Second Circuit, by a 2-1 majority, held that this determination was not erroneous. The question presented by the instant petition is straightforward: Should that essentially factual finding be reviewed in this Court? The question, respondents submit, answers itself.

This case raises no novel or significant issue of law. It has long been settled that Person A will not be deemed the beneficial owner of stock owned by Person B for purposes of ascertaining statutory insider status — even if Persons A and B are somehow related — unless Person A receives some direct pecuniary benefit from the sale of Person B's stock. Thus, the holdings of two or more related persons who own stock in the same company may not be aggregated for purposes of determining who is a 10% statutory "insider" unless each person shares directly in the proceeds from the sale of stock owned by the others. This is true even if those same persons would be deemed "beneficial owners" of each other's stock for purposes of those sections of the Exchange Act that impose reporting requirements on so-called "groups," such as §§ 16(a) and 13(d).

The Second Circuit applied this long-standing rule when it refused to attribute to respondent APL Corporation beneficial ownership of Peabody common stock belonging to other respondents, even though all the respondent corporations had the same Chairman of the Board, and were therefore a § 13(d) "group." As a result, APL was only required to disgorge short-swing profits on 290,100 of the 1,421,800 Peabody shares it owned. Had APL been deemed the

1/ Section 16(a) defines a statutory insider as one who is "directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security [of the issuer, or who is] a director or an officer of the issuer of such security." 15 U.S.C. § 78p(a).

beneficial owner of the Peabody stock belonging to its co–respondents, it would have had to disgorge the profit on all 1,421,800 shares.

Review of the Second Circuit's decision would be inappropriate. All the circuits agree that related parties must receive direct pecuniary benefit from the sale of subject shares in order to be deemed beneficial owners of those shares for § 16(b) purposes. Whether APL and its co-respondents, including Victor Posner, received direct pecuniary benefit from each other's stock transactions is a question of fact that is beyond this Court's province to review.

The petition should be denied.

Statement of the Case

This case grew out of the long and often acrimonious relationship between Peabody International Corporation, its four principal stockholders (respondents Chesapeake Insurance Company, DWG Corporation, National Propane Corporation, and APL Corporation) and Victor Posner, who served as Chairman of the respondent companies.

Between 1981 and 1983, Chesapeake, DWG and National Propane each purchased Peabody common stock. All three purchasers were substantial companies, engaged in substantial businesses, employing thousands of people at dozens of locations throughout the country. DWG was a publicly traded company with thousands of stockholders; Chesapeake and National Propane were operating subsidiaries of public companies whose shares were also widely held.

By November 1983, the three companies' combined holdings equalled about 23% of Peabody's outstanding common stock. Because Victor Posner was Chairman of all three companies, they reported their holdings as a "group" under § 13(d) of the Securities and Exchange Act of 1934. At all times, each of the three companies disclaimed beneficial ownership of each other's shares.

Despite their substantial holdings, none of these defendants nor anyone affiliated with them had any representation in Peabody's man-

agement or on its Board. Nonetheless, two years after the last purchase of Peabody stock by respondents, on June 19, 1985, Peabody entered into a defensive merger agreement with a "white knight," the Pullman Company. This "lock-up" agreement effectively diluted the interest of the Chesapeake-DWG-National Propane group, and gave Pullman a *de facto* veto over any competing takeover proposal.

Once the lock-up was in place, Pullman's President, Thomas Begel, tried to win Posner's support for the proposed merger. In July and August 1985, Begel offered, both orally and in writing, to pay the shareholder corporations as much as $4 million for a standstill agreement under which Chesapeake, DWG and National Propane would refrain from increasing their interest in Peabody and would vote for the merger. Begel's proposal did not contemplate that the three corporations would sell their Peabody stock in exchange for accepting this payment. Posner, acting on behalf of the three corporations, declined Begel's offers.

Between August 7 and September 19, APL (another public company chaired by Victor Posner) purchased 1,421,800 shares of Peabody common stock, or 12.5% of the company's outstanding shares. APL's holdings rose above 10% of Peabody's stock on August 23; it purchased 290,100 shares thereafter.

On August 27, Peabody and Pullman entered into two additional "defensive" agreements that had the effect of preventing Chesapeake, DWG, National Propane and APL from voting either for or against the proposed merger. Lawsuits among Peabody, Pullman and various of the respondents were already pending in Connecticut and Florida, and respondents announced their intention to oppose the proposed Peabody-Pullman merger and to challenge the lock-ups in court.

Ultimately, the parties settled. On September 20, Peabody, Pullman and respondents entered into an agreement under which Peabody and Pullman agreed to pay $5.6 million for (1) a settlement of all pending litigation, and (2) a five year standstill that barred the four stockholder corporations, Posner, and anyone affiliated with them from

threatening the Peabody-Pullman merger or from acquiring any stock in the merged entity. These terms were substantially similar to those Begel had offered some weeks earlier in exchange for a $4 million payment.

Each of the four companies that had invested in Peabody realized income from the settlement fund in proportion to its ownership of Peabody stock. As petitioner stipulated, none of the other respondents, including Victor Posner, received any proceeds from the settlement.

On the same day that the settlement and standstill agreement was signed, the four stockholding companies sold their Peabody shares to thirteen unaffiliated third-party purchasers. Each of the four selling respondents received the entire proceeds from the sale of the shares it owned; no other respondent shared in those proceeds.

Proceedings Below

Petitioner Mayer commenced this derivative action on October 9, 1985. She alleged that the $5.6 million paid under the September 20 agreement was actually consideration for the sale of the stockholders-respondents' Peabody shares, and that the agreement was a sham and a subterfuge designed to hide the fact. Mayer also contended that, in determining beneficial ownership for purposes of ascertaining when APL became a 10% holder of Peabody stock, the stock owned by Chesapeake, DWG and National Propane should be beneficially attributed to APL. If this were done, then APL was already a statutory insider when it began purchasing Peabody stock for its own account, and the profit on all of APL's 1,421,800 Peabody shares, not just the last 290,100 purchased, would have been subject to disgorgement.

District Court Decision

On October 11, 1988, after a bench trial (at which nearly all the relevant facts were stipulated), the district court issued Findings of Fact and Conclusions of Law pursuant to Fed. R. Civ. P. 52(a). The

district court found that the standstill and settlement agreement was not a sham, but rather that it conferred significant independent benefits on Peabody and Pullman by ending formidable opposition to their merger, terminating two lawsuits, and preventing respondents from taking a position in the merged company. (A. 9–10) 2/ Expressly rejecting the testimony of plaintiff's so-called "expert" (A. 6), the district court further found that $4.6 million of the $5.6 million settlement was paid in consideration for those benefits. (A. 10)

The court also found that the respondents could not be deemed to be the beneficial owner of each other's shares for § 16(b) purposes. (A. 9) The district court judge applied the so-called "direct pecuniary benefit" rule, which states that a party who is not the actual owner of stock cannot be deemed the § 16(b) beneficial owner of those shares unless he receives some direct pecuniary benefit from the actual owner's transactions in the subject stock. (A. 9) Since the evidence established that no respondent derived any direct pecuniary benefit from the sale of Peabody shares owned by any other respondent, APL — the only respondent which bought and sold Peabody stock within six months — was not already the beneficial owner of more than 10% of Peabody's stock when it began purchasing Peabody shares in August 1985. (A. 9) It did not become a statutory insider for § 16(b) purposes until August 23, when it purchased enough stock for its own account to cross the 10% threshold. (A. 10) Thus, only the profit on the 290,100 shares APL purchased after that date was subject to disgorgement. (A. 10–11)

In calculating the disgorgeable amount, the district court did not "offset losses against gains," as alleged in the petition. It applied the formula outlined by the Second Circuit in *Herrmann* v. *Steinberg*, 812 F.2d 63, 67 n.5 (2d Cir. 1987), a § 16(b) case involving almost identical facts. It concluded that APL's short-swing profits on the sale of its 290,100 short-swing shares amounted to $4,858.50. (A. 10–11)

2/ Appendix references are to the petition appendix.

On October 31, 1988, the district court entered final judgment against APL in the amount of $5,980.80 ($4,858.50 plus interest) and dismissed the complaint as against the other respondents. (A. 11)

Court of Appeals Decision

On appeal, the Second Circuit affirmed. The majority (Kearse and Winter, JJ.) affirmed that direct pecuniary benefit was the appropriate test of beneficial ownership in this § 16(b) case. (A. 24–27) The majority recognized that a non-owning party could receive a direct pecuniary benefit from the sale of another's stock in several circumstances, including (1) where the non-owning party has "absolute control over a subsidiary that owns the stock," (A. 21), (2) where the non-owner "has absolute control over the transactions *and* directly benefits from the profits" (A. 23) (emphasis added), or (3) where the non-owner "shared benefits substantially equivalent to ownership." (A. 24) But it found no error in the district court's application of the facts to these tests, or in its conclusion that no respondent received any direct pecuniary benefit from the sale of any other respondent's Peabody stock. (A. 27–29) In particular, the majority affirmed the district court's finding that Victor Posner received no direct pecuniary benefit. (A. 28–29)

In dissent, Judge Sweet indicated that because Posner could control the decision to acquire or dispose of Peabody stock by the four companies, they should be treated as a single beneficial owner of each other's shares, whether or not Posner received any direct pecuniary benefit from the sale of any respondent's Peabody stock. (A. 39)

The entire panel agreed that the district court had not clearly erred in finding as a matter of fact that the standstill agreement conferred value of $4.6 million on Peabody and Pullman. (A. 33–35, 40)

Reasons For Denying the Writ

THIS CASE PRESENTS NO QUESTION OF GENERAL IMPORTANCE WARRANTING REVIEW BY THIS COURT

I. The Second Circuit's Invocation of The "Direct Pecuniary Benefit" Rule is Consistent With All Relevant Authority

Petitioner contends that the Second Circuit has adopted a novel construction of § 16(b) beneficial ownership in this case. However, it is petitioner's argument, not the decision below, that conflicts with all pertinent authorities.

The direct pecuniary benefit test of § 16(b) beneficial ownership is a rule of long standing. Over a quarter-century ago, in *Blau* v. *Lehman*, 368 U.S. 403, 414 (1962), Justice Black recognized that a § 16(b) insider must disgorge only profits "realized *by him*," not by some affiliated party. This standard has been reaffirmed in an unbroken line of cases, all of which hold that a party who does not actually purchase and sell stock within six months while a statutory insider is not the beneficial owner of those shares for § 16(b) purposes unless some direct pecuniary benefit from the transaction flows to him. *E.g.*, *CBI Industries, Inc.* v. *Horton*, 682 F.2d 643, 646 (7th Cir. 1982); *Whiting* v. *Dow Chemical Co.*, 523 F.2d 680, 688 (2d Cir. 1975); *Margolies* v. *Rea Bros.*, [1982–83 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,261, at 96,179 (S.D.N.Y. 1983).

The direct pecuniary benefit rule has been strictly construed; it applies even if the non-trading party is so related to the trading party that he would be deemed the "beneficial owner" of those same shares for the purposes of other sections of the Exchange Act, such as those that impose reporting requirements on members of a corporate control "group." *Whiting, supra*, 523 F.2d at 685 n.8; *Heublein, Inc.* v. *Gen-*

eral Cinema Corp., 559 F. Supp. 692, 705 (S.D.N.Y.), *aff'd*, 722 F.2d 29 (2d Cir. 1983), *cert. denied*, 465 U.S. 1066 (1984).

Petitioner contends that the direct pecuniary benefit rule is at odds with the SEC's interpretation of the term "beneficial ownership" for § 16(b) purposes. As the Second Circuit recognized, petitioner is wrong. In 1938, the SEC's General Counsel opined that a non-owning party could be deemed the "beneficial owner" of stock belonging to someone else for § 16(b) purposes only where the non-owner could use the actual owner of stock as a "personal trading or investment medium," and where the actual owner of the subject stock "has no other substantial business." Exchange Act Release No. 34-1965 [Permanent Binder 4] Fed. Sec. L. Rep. (CCH) ¶ 26,041, at 19,060 (December 21, 1938). A personal trading or investment medium that has no other business necessarily yields direct pecuniary benefit to the person who controls it. This is but another way of describing the direct pecuniary benefit rule.

The lower courts here ruled as a matter of fact that the evidence before them did not support any inference that the respondent corporations were Victor Posner's personal trading or investment companies or that they had no other substantial business. Hence, under the SEC's traditional interpretation of § 16(b) "beneficial ownership," respondents could not be deemed beneficial owners of each other's stock.

Last December — over three years after the events that are the subject of this action took place — the SEC announced a proposed rule that would change the definition of "beneficial ownership" under § 16(b) for the purpose of ascertaining who is a 10% owner of subject stock. This proposed new definition would permit a finding of beneficial ownership even when a non-owning party did not receive any direct pecuniary benefit from the subject stock transaction, as long as the non-owner had sufficient "potential for control" over the owner. Exchange Act Release No. 26333 [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,343, at 89,603 (December 2, 1988). In an-

nouncing this proposed rule, the SEC specifically noted that its proposed definition of § 16(b) beneficial ownership "would go beyond most of the judicial decisions and state that some indirect pecuniary interest is sufficient to convey beneficial ownership." (*Id.* at n.57). Thus, the SEC has explicitly acknowledged that the law applied by the Second Circuit in this case — the direct pecuniary benefit rule — was the law at the time of the transactions at issue.

Petitioner urged the lower courts to adopt the SEC's as yet unadopted rule retrospectively and to apply it to a case that arose three years before the proposed rule was announced. Both courts quite properly declined to do so. 3/

In light of the SEC's proposal to change the interpretation of the term "beneficial ownership," this case hardly presents any issue of public importance. Review by this Court would not provide guidance to the lower courts for future cases. Rather, it would interpret a rule that soon may be no longer in effect — making the question important only to this particular case and not generally. Such an issue is not worthy of certiorari. *Layne & Bowler Corp.* v. *Western Well Works, Inc.*, 261 U.S. 387, 393 (1923) (Supreme Court decides only issues of public importance).

Petitioner's argument that the Second Circuit's decision raises a conflict between the circuits also has no merit. *Whittaker* v. *Whittaker Corp.*, 639 F.2d 516 (9th Cir), *cert denied*, 454 U.S. 1031 (1981), the allegedly conflicting decision, is in fact consistent with the Second Circuit's ruling.

As the majority below recognized, *Whittaker* applied the very same direct pecuniary benefit test that was relied on in this case. The Ninth Circuit reached a different result — it held the non-owner liable

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3/ The error in the dissent, respondents submit, was that Judge Sweet relied heavily on this proposed SEC rule, without acknowledging (as the SEC itself had) that this new interpretation was contrary to the law that existed at the time the events in this case took place.

for disgorgement — but only because the facts in *Whittaker* were very different than those at bar. In *Whittaker*, the non-owning party — the son of the actual shareholder — exercised virtually complete control over his mother's affairs and had the unfettered ability to use for his personal account the profits from transactions in the stock owned by his mother. *Id*. at 524. Thus, the Ninth Circuit could fairly conclude as a matter of fact that the profits inuring to the account of the mother afforded direct pecuniary benefit to the son.

In this case, the district court made precisely the opposite finding — that neither Victor Posner nor any of the other so-called "Posner defendants" had the ability to commingle APL's funds with those of other corporations or to use the proceeds of its stock transactions for their own account. That finding was not deemed clearly erroneous by the Second Circuit; it is unassailable here.

Petitioner also suggests that the Court of Appeals' ruling is at odds with an earlier Second Circuit decision, *Blau* v. *Mission Corp.*, 212 F.2d 77 (2d Cir.), *cert. denied*, 347 U.S. 1016 (1954). Putting to one side the question of whether an alleged intra-circuit conflict, as opposed to inter-circuit conflict, is ripe for review by this Court, 4/ the Court of Appeals majority quite properly recognized that there was a fundamental factual distinction between *Mission* and this case. In *Mission*, the issue was whether a majority shareholder, who had absolute control over a non-diversified, closed-ended management company (which fits precisely within the definition of a "personal trading or investment medium") could be deemed the beneficial owner of shares owned by that management company. In this case, the issue was whether Victor Posner, as Chairman of public companies with numerous shareholders and substantial operating businesses, so completely controlled those companies that he could share directly in the proceeds of stock transactions made by the companies.

4/ Supreme Court Rule 17 states that the Court will consider granting certiorari in a case where there is a conflict between one federal court of appeals and another, not in a case of intra-circuit conflict.

In the end, the distinction among cases like *Whittaker* and the case at bar lies in their facts. The courts all applied the direct pecuniary benefit rule; they reached different results because, for example, in *Mission* and *Whittaker*, the facts revealed that the non-owning party received a direct pecuniary benefit, while in this case the facts revealed otherwise. This distinction only underscores why it would be improper to grant the petition here.

II. Petitioner's "Form Over Substance" Argument is a Disguised Request for Review of Findings of Fact.

Petitioner asks this Court to grant certiorari to review the finding that $4.6 million of the $5.6 million payment from Pullman to respondents was made in exchange for the benefits conferred by the standstill and settlement agreement. (Pet. at 9–12) Petitioner continues to urge that those benefits were worthless and a sham.

However, whether the standstill and settlement covenants had value and, if so, how much, are pure questions of fact. Even the dissenting judge in the Second Circuit recognized that it was "indeed appropriate" for the panel to uphold this purely factual finding, since it was not clearly erroneous. (A. 40) This Court has repeatedly held that it will not review factual determinations in which the district courts and courts of appeals have concurred. *Rogers* v. *Lodge*, 458 U.S. 613, 623 (1982); *Branti* v. *Finkel*, 445 U.S. 507, 512 n.6 (1980); *Berenyi* v. *District Director, Immigration and Naturalization Service*, 385 U.S. 630, 635 (1967).

CONCLUSION

The petition for a writ of certiorari should be denied.

Dated: New York, New York
November 21, 1989

Respectfully submitted,

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RESPONDENTS

No. 89-663

In The

Supreme Court of the United States

October Term, 1989

MARY MAYER,

Petitioner,

-against-

CHESAPEAKE INSURANCE COMPANY LIMITED, DWG CORPORATION, NVF COMPANY, NATIONAL PROPANE CORPORATION, APL CORPORATION, CHESAPEAKE FINANCIAL CORPORATION, SOUTHEASTERN PUBLIC SERVICE COMPANY, VICTOR POSNER, PEABODY INTERNATIONAL CORPORATION, THE PULLMAN COMPANY, and PTC ACQUISITION, INC.

Respondents.

PETITIONER'S REPLY BRIEF

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PETITIONER'S REPLY BRIEF

POINT I

DIRECT PECUNIARY BENEFIT IS NOT THE TEST OF BENEFICIAL OWNERSHIP UNDER SECTION 16(b)

Respondents contend that "direct pecuniary benefit" is the indispensable test of beneficial ownership under Section 16(b). They rely heavily upon two SEC releases 50 years apart. However, the 1938 Release, Exchange Act Release No. 34-1965 [Permanent Binder 4] Fed. Sec. L.

Rep. (CCH) ¶26,041 (December 21, 1938), has been superseded. And respondents have misstated the contents of the 1988 release, Exchange Act Release No. 26333 [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶84,343 (December 2, 1988).

The 1938 release relied upon by respondents (Br. 9) has been superseded by numerous judicial and SEC pronouncements. (See Pet. 6-8). Exchange Act Release No. 34-18114, entitled "Interpretive Release on Rules Applicable to Insider Reporting and Trading", 4 Fed. Sec. L. Rep. (CCH) ¶23,062 (September 23, 1981), clearly discarded the requirement of direct pecuniary benefit. In that release, the SEC posed and answered numerous questions regarding the interpretation of Section 16 and the rules promulgated thereunder. One question asked whether the beneficiary of an irrevocable trust which holds shares of common stock of a registered company would be regarded as the beneficial owner of those shares if he has the right to vote them but "receives income from them only in the discretion of an independent trustee." The SEC answered as follows:

> *Answer*: Yes. As already noted, the term "beneficial ownership" of securities has not been specifically defined by the Commission for purposes of Section 16. It is generally recognized, however, that among the hallmarks of beneficial ownership are the right to control voting and transfer; the right to receive or control the disposition of income; and the right to control disposition of proceeds upon liquidation. *Not all of these characteristics need be present in order for beneficial ownership to exist*. In this case, since the insider *may* receive income from the trust, and since he does have the right to vote

> the trust securities, it appears that he receives benefits sufficient to constitute him the beneficial owner of securities held in the trust.

Id. at 19,063-21-22 (emphasis added).

See also, "Section 16 of the Exchange Act", Exchange Act Release No. 34-7793, 4 Fed. Sec. L. Rep. (CCH) ¶26,032 (January 19, 1966).

Nor does the fact that the intermediary companies conduct business (Resp. Br. 3, 9) insulate the Posner Group from liability. In 1953, the then SEC chairman stated: "The primary character of the business of a holding company is . . . irrelevant if the company is in fact used as a corporate cloak to hide insider trading." Cook and Feldman, *Insider Trading Under the Securities Exchange Act*, 66 Harv. L. Rev. 385, 402 n.73 (1953).*

Respondents concede that the SEC has recognized that beneficial ownership depends upon the potential for control (Br. 9). They contend, however, that the SEC position is an expansion of existing law (Br. 10), quoting footnote 57 from the 1988 Release. However, the quotation refers not to the definition of beneficial ownership (which the SEC points out has evolved under case law), but rather to the determination of which *transactions* should be subject to reporting and profit recovery.

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* Respondents seek to build upon the opinions of the courts below by suggesting that the $5,600,000 payment was for settlement of litigation (Br. 4, 12). However, as the dissent noted (A. 40), the settled actions were *against* Posner and the threatened counterclaims were derivative in nature, so that sale of the stock terminated his standing to maintain them.

Indeed, the text to which footnote 57 is appended specifically refers to Proposed Rule 16a-l(a)(2) which refers to a number of types of transactions, some of which were not previously covered by decided cases. Thus, the portion of the Release quoted by respondents serves to highlight the fact that direct pecuniary benefit was not a pre-existing requirement that the SEC eliminated in 1988, for had it been the SEC's belief that it was expanding the law, the agency would have said so as it did in the case of transaction specification.

POINT II

THE POSSIBILITY OF A NEW SEC RULE DOES NOT MILITATE AGAINST THE NEED FOR THIS COURT'S DETERMINATION OF THE ISSUES PRESENTED BY THE PETITION.

The respondents assert that this Court should refuse to take this case and do justice because the SEC may adopt a rule which will be determinative of situations such as the present one. Putting aside the fact that the SEC rule proposal was made one year ago and has not yet been adopted, its adoption (if ever) would hardly resolve the issues presented by this case. This Court has stated that it would not afford the SEC's views "the deference to which the views of the agency administering a statute are usually entitled" in cases involving interpretation of Section 16(b). *Foremost-McKesson v. Provident Securities Co.*, 423 U.S. 232, 259 (1976). It was presumably a reliance upon the apparent divergence between Commission and court holdings that led the court below to its erroneous decision. At the time of its decision, the SEC had already issued its interpretive release and proposed rules, and

these had been called to the court's attention. Nevertheless, the Court of Appeals declined to give the agency the deference which one would expect that it be accorded. Accordingly, it is necessary for this Court to resolve this conflict and issue an authoritative interpretation of the statute.

CONCLUSION

For the reasons set forth above and in the Petition, the Petition for a Writ of Certiorari should be granted.

Dated: New York, New York
November 27, 1989

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